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SUBJECT: IMPACT OF THE GLOBAL FINANCIAL CRISIS ON EAST
KALIMANTAN

Classified By: DCM John A. Heffern, reasons 1.4(b+d)

¶1. (SBU) SUMMARY: The global financial crisis is having a significant impact on the natural resource dependent economy and politics of East Kalimantan, Indonesia's second largest province. The drop in commodity prices is slowing illegal logging, but deforestation continues. Furthermore, the inability of democratically elected leaders to provide economic development there is increasing voter apathy. END SUMMARY.

GLOBAL FINANCIAL CRISIS FELT

¶2. (U) During a January 2009 trip to the Borneo province of East Kalimantan Emboff spoke to residents, business people, NGOs, and local politicians about the current economic and environmental condition. Deforestation, due to logging and expansion of lucrative palm oil plantations, is increasing political tensions in the region. Deforestation also contributes to Indonesia's status as one of the world's largest carbon emitters. East Kalimantan's economy--based largely on natural resource exploitation, is beleaguered by land rights disputes and corruption. While high commodity prices in recent years have allowed the region to prosper, the global financial crisis and unstable commodities markets are creating uncertainties for these resource dependent communities. This economic squeeze could affect upcoming elections in Kalimantan and hamper government plans for economic development.

FORESTRY HIT HARD

¶3. (U) The global financial crisis has hurt the principal livelihood in East Kalimantan - forestry. Decreased demand for wood, particularly from Japan and the U.S., combined with a difficult credit climate have crippled both the legal and illegal logging industries. The high cost of credit means operators are unable to obtain financing and are shifting to cash operations. This crunch comes at an inopportune time for sustainable forestry efforts. Enforcement activities and educational efforts had been having some impact on reducing illegal logging in key areas. Although lack of demand has caused illegal logging and land conversion to slow, declining profits also mean companies lack funds for community development projects. Nor can companies afford to implement environmentally friendly best practices. The closure or reduced operations of several companies is increasing unemployment not only in the forestry sector, but in secondary sectors such as saw mills, river boat operators and food vendors. According to The Nature Conservancy's forestry expert, demand is so low that there are few buyers for wood legally harvested from concession forests (HPHs).

PALM OIL COLLAPSE HITS SMALLHOLDERS

14. (U) The drop in the price of crude palm oil (CPO) has had limited impact on large companies while for small businesses the effects were more dramatic. CPO recently plummeted to a low of \$480 per metric ton from a November 2008 high of over \$1300. This drop is causing large established companies to delay expansion plans, and smaller companies to close or scale back operations, but "smallholders" are being hit the hardest. (Note: Smallholders are farmers with approximately two hectares of land who receive all their inputs, such as seeds and fertilizer, from large palm oil companies. They are then forced to sell their product back to the sponsor company.) To maintain profit margins these large sponsor companies are simply paying farmers less for their products and driving them into poverty.

15. (C) Although companies have delayed expansion plans and are not currently converting or planting new land in order to increase production, their appetite for land remains. Companies believe CPO prices will rebound and know that available land is limited. Local officials remain eager to sell land because despite commodity market volatility, they see palm oil as the key to local economic development. Many local politicians are also particularly agreeable to "new investments" now because proceeds diverted from these sales can be used to finance upcoming election campaigns. As a result of all this, companies continue to buy land for possible later use.

POLITICAL FALLOUT

16. (C) The November 2008 election of East Kalimantan Governor
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18. Awang Farouk Ishak is not a welcome development for the environment. Prior to the election he oversaw the regency with arguably the worst environmental record in Indonesia. For example, mining concessions and land clearing for highway construction have destroyed 70% of the forest in Kutai National Park, an environmentally critical conservation area. An environmental NGO claimed Gov. Farouk received almost 100 percent of the votes in areas around the park after turning a blind eye to encroachment into the park.

17. (SBU) The result is particularly disheartening when one considers that Mayor H. Jusuf Serang Kasim of Tarakan (a city island in North-East Kalimantan) was also a candidate. Tarakan received a decentralization award in 2007 from the Center for Pro-Autonomy, an award for good environmental stewardship and Jusuf was just named as an outstanding regional leader in leading news magazine Tempo's "Figures of 2008." Over the last ten years of decentralization he worked to build new schools including a university, provide free health care to the region's poor, and stimulate economic growth that has always outpaced the national growth rate. Despite his many successes he was unable to garner sufficient support to win the governorship.

PARTIES JOCKEY FOR ADVANTAGE

18. (C) Money politics and vote buying are alive and well in East Kalimantan despite enforcement efforts - including fines imposed on the November 2008 gubernatorial candidates for election violations. Most political parties here garner support not with platforms and policies, but with parties and puppet shows. Often candidates buy votes with food, clothing or cash. The declining profitability of palm oil and logging means that politicians are increasingly turning to lucrative coal concessions to finance their campaigns.

PRABOWO'S PARTY GAINING GROUND

19. (C) According to contacts, voter apathy among educated middle class voters in East Kalimantan is increasing. A social welfare NGO estimated that nearly 40% of eligible voters in East Kalimantan did not vote in the 2004 election,

(compared to Indonesia's overall voter turnout of 90% in 2004) and fewer would vote this year. This means that election outcomes may well be determined by unsophisticated voters in rural areas. This is particularly concerning given the grassroots support for the political party Gerindra and its presidential candidate Prabowo (one name only). Prabowo, a former general, is widely suspected of involvement in human rights violations during his military career.

¶10. (C) Prabowo is financing his campaign through several large companies he owns in East Kalimantan including huge coal mining operations and a large pulp and paper/ timber concession. His focus on rural farmers attracts people who lack the access to information or motivation to examine his background. Ordinary voters frequently told Emboff that Gerindra had the best advertisements and promotional campaign. Almost 50% of the workforce in East Kalimantan is agriculture, 90% of which is in the informal employment sector, i.e. mostly rural subsistence farmers.

¶11. (SBU) The overall consensus among contacts is that large established parties like PDI-P and Golkar will fare the best in the upcoming election. However, the PDI-P's campaign against high food prices is alienating the very segment most attracted to Gerindra--the farmers who will lose money if prices decrease. There are indications that PKS (an Islamic-oriented party) may improve its position, particularly if SBY falters. NGOs contacts told us that PKS has increased support among the middle class, and is attracting increasingly more non-Muslim followers.

¶12. (C) The increasing unemployment and poverty rates triggered by the commodity collapse combined with a lack of measurable outcomes from political democratization are leaving many voters in East Kalimantan disenchanted. While most agree decentralization is good in theory, the implementation has been uneven. Mayor Jusuf asserts that decentralization has lacked sufficient guidance and has served to build "little kings" out of regents and mayors who misuse the money, increase taxes, and fail to invest in developing human resources. It is this misuse which garners the attention of both the local population and the central government.

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